

STATE OF VERMONT
PUBLIC SERVICE BOARD

INVESTIGATION INTO GENERAL ORDER NO. 45)
NOTICE FILED BY VERMONT YANKEE NUCLEAR) Docket No. 6545
POWER CORPORATION RE: PROPOSED SALE)
OF VERMONT YANKEE NUCLEAR POWER)
STATION AND RELATED TRANSACTIONS)

DIRECT TESTIMONY OF

ANDREA C. CRANE

ON BEHALF OF

THE DEPARTMENT OF PUBLIC SERVICE

January 7, 2002

Summary: Ms. Crane's testimony reviews the organizational and financial relationships proposed among ENVY, its parent and its affiliates. In her testimony, Ms. Crane provides recommendations regarding financial safeguards that should be adopted in order to ensure that ENVY has access to the capital required to meet its service and contractual obligations. Ms. Crane concludes that the Board should require Entergy Corporation to provide certain financial guarantees for ENVY. Ms. Crane also proposes dividend and loan restrictions for ENVY and recommends various financial reporting requirements.

TABLE OF CONTENTS

	Page
I. Statement of Qualifications	3
II. Purpose of Testimony	4
II. Summary of Recommendations	5
IV. Discussion of the Issues	
A. Organizational Structure	7
B. Financial Assurances	14
C. Recommended Restrictions on ENVY	27
V. Conclusions	31

Exhibit DPS-ACC-1 List of Prior Testimonies

Exhibit DPS-ACC-2 Referenced Data Requests and Other Documents

I. STATEMENT OF QUALIFICATIONS

Q. Please state your name and business address.

A. My name is Andrea C. Crane and my business address is 38C Grove Street, Ridgefield, Connecticut 06877.

Q. By whom are you employed and in what capacity?

A. I am Vice President of The Columbia Group, Inc., a financial consulting firm that specializes in utility regulation. In this capacity, I analyze rate filings, prepare expert testimony, and undertake various financial studies regarding utility rates and regulatory policy.

Q. Please summarize your professional experience in the utility industry.

A. Prior to my association with The Columbia Group, Inc., I held the position of Economic Policy and Analysis Staff Manager for GTE Service Corporation, from December 1987 to January 1989. From June 1982 to September 1987, I was employed by various Bell Atlantic (now "Verizon") subsidiaries. While at Bell Atlantic, I held assignments in the Product Management, Treasury, and Regulatory Departments.

Q. Have you previously testified in regulatory proceedings?

A. Yes, since joining The Columbia Group, Inc., I have testified in over 130 regulatory proceedings in the states of Arizona, Delaware, Connecticut, Hawaii, Kansas, Maryland, New

1 Jersey, New Mexico, New York, Oklahoma, Pennsylvania, South Carolina, Rhode Island,
2 Vermont, West Virginia, and the District of Columbia. These proceedings involved electric,
3 gas, water, wastewater, telephone, solid waste, cable television, and navigation utilities. A
4 list of dockets in which I have filed testimony is included in Exhibit DPS-ACC-1.

5
6 **Q. What is your educational background?**

7 A. I received a Masters degree in Business Administration, with a concentration in Finance, from
8 Temple University in Philadelphia, Pennsylvania. My undergraduate degree is a B.A. in
9 Chemistry from Temple University.

10
11 **II. PURPOSE OF TESTIMONY**

12 **Q. What is the purpose of your testimony?**

13 A. The Columbia Group, Inc. was engaged by the State of Vermont, Department of Public
14 Service (“Department” or “DPS”) to review certain aspects of the proposed sale of the
15 Vermont Yankee Nuclear Power Station (“Vermont Yankee”) in Vernon, Vermont to
16 Entergy Nuclear Vermont Yankee (“ENVY” or “Company”), a subsidiary of Entergy
17 Corporation. Specifically, we were engaged to review the organizational relationships
18 proposed among ENVY, its parent and its affiliates and to provide testimony on behalf of the
19 DPS to the State of Vermont, Public Service Board (“Board”) regarding 1) the
20 appropriateness of the organizational design; and 2) additional safeguards that may be

1 necessary in order to ensure that ENVY has access to the capital required to meet its service
2 and contractual obligations. In determining my recommendations, I reviewed the prefiled
3 testimony and exhibits of Mr. Kansler and Mr. Wigget, the responses to data requests
4 propounded upon ENVY by the Department, the Company's Application to the Nuclear
5 Regulatory Commission ("NRC"), and other documents useful in an analysis of the
6 Company's proposal.

7
8 **III. SUMMARY OF CONCLUSIONS**

9 **Q. Based on your review, what are your conclusions and recommendations regarding the**
10 **proposed organizational structure?**

11 **A.** My conclusions and recommendations are as follows:

- 12 1. The financial assurances and lines of credit proposed pursuant to the
13 Application are insufficient.
- 14 2. As a condition of the Board approving the sale, Entergy Corporation and
15 ENVY must agree to certain conditions designed to ensure that Entergy
16 Corporation provides, and ENVY receives, a fair share of capital available
17 from Entergy Corporation.
- 18 3. The Board should require Entergy Corporation to provide a financial
19 guarantee for ENVY that provides ENVY with sufficient funds to cover at
20 least one year of expenses for Vermont Yankee.

- 1 4. The Board should also require Entergy Corporation to provide a separate line
2 of credit of \$35 million to be used for working capital by ENVY.
- 3 5. The Board should be kept informed of ENVY's financial position including
4 its use of lines of credit and other financial guarantees.
- 5 6. The Board should be provided with full and complete disclosure of all current
6 financial obligations of Entergy Corporation and its affiliates, including off-
7 balance sheet obligations, in order to determine the parent company's overall
8 financial strength.
- 9 7. ENVY should agree to limit its dividends to its parent to 50% of net income
10 for the first three years of operation. After the first three years of operation,
11 the Board should reevaluate the need for, and the level of, any dividend
12 restriction.
- 13 8. ENVY should agree to receive Board approval prior to making any loans to
14 affiliates.
- 15 9. The recommendations contained in this testimony may not be sufficient to
16 provide adequate assurances to the Board regarding the financial commitment
17 of ENVY and Entergy Corporation to the continued operation of Vermont
18 Yankee. The Board should require whatever additional conditions it believes
19 are necessary in order to provide adequate safeguards to the ratepayers and
20 taxpayers in Vermont.

1
2 **IV. Discussion of the Issues**

3 **A. Organizational Structure**

4 **Q. Why is it important to review the organizational structure proposed for the ownership**
5 **of Vermont Yankee by ENVY?**

6 A. It is important to consider the organizational structure in order to ensure that the corporate
7 entity that will own the Vermont Yankee facility has the financial means to operate the
8 facility, to absorb the financial impacts of unforeseen negative events, and to access capital
9 that may be needed for the continued operation of Vermont Yankee. While it is reasonable
10 to assume that Entergy Corporation, which is the entity providing the capital for the proposed
11 purchase, has a vested interest in ensuring sufficient cash for operations, the fact is that
12 Entergy Corporation also has a vested interest in protecting its other assets as much as
13 possible from exposure due to potential negative consequences of its nuclear operations.
14 Therefore, Entergy Corporation has a vested interest in designing an organizational structure
15 that will provide maximum benefit to shareholders as a result of the ownership of Vermont
16 Yankee while shielding those shareholders from any negative consequences resulting from
17 that ownership.

18 At the same time, the Board must ensure that Vermont ratepayers have a stable and
19 economic source of electricity. The State of Vermont also has an interest in ensuring the
20 availability of economic energy to its residents and businesses while maintaining the

1 environmental safeguards necessary to protect the State and its citizens from negative
2 environmental consequences. Thus, the issues to be addressed in this proceeding affect
3 Vermont's electric supply, its economy, and its environment.
4

5 **Q. How will the sale of Vermont Yankee affect the Board's oversight of the facility?**

6 A. Vermont Yankee is currently owned by Vermont Yankee Nuclear Power Corporation, whose
7 shareholders consist of regulated utilities. Moreover, these shareholders are required to
8 purchase the output of the facility pursuant to contracts approved by the Federal Energy
9 Regulatory Commission ("FERC"). Therefore, Vermont Yankee is currently backed by the
10 full faith and credit of its owner utilities, and by the ratepayers of those utilities. If the
11 proposed sale is consummated, the facility will become an exempt wholesale generator
12 ("EWG"), dependent upon the resources of its corporate parent and the vagaries of the capital
13 markets for support. Therefore, the Board must carefully evaluate the conditions of sale that
14 are necessary to protect Vermont's ratepayers and citizens and should approve the sale of the
15 facility only upon acceptance of those conditions by the new owner.
16

17 **Q. Are there other concerns about organizational structure?**

18 A. Yes, in addition to being concerned about the availability of capital for ENVY's operations,
19 there is also a concern that Entergy Corporation may threaten the long-term financial viability
20 of ENVY by using ENVY's earnings to fund other Entergy Corporation operations, leaving

1 insufficient funds in ENVY for nuclear operations. Therefore, in addition to raising concerns
2 about the availability of sufficient operating and capital funds, I am also concerned about the
3 need to retain capital in ENVY. The Board should avoid a repeat of the situation that
4 transpired in Pacific Gas and Electric ("PG&E") and in other California utilities whereby
5 funds were funneled from a successful operating entity to the holding company, leaving the
6 operating company in dire financial straits. Therefore, the Board needs to be concerned
7 about both the flow of funds to ENVY and the flow of funds from ENVY to the parent.
8

9 **Q. How is Entergy Corporation proposing to structure its Vermont Yankee operations?**

10 A. The proposed corporate structure is shown in Exhibit MRK-3 to Mr. Kansler's testimony.
11 ENVY will be owned by Entergy Nuclear Vermont Investment Company, which is a wholly-
12 owned subsidiary of Entergy Nuclear Holding Company #3. Entergy Nuclear Holding
13 Company #3 is a wholly-owned subsidiary of Entergy Nuclear Holding Company, which is
14 a wholly-owned subsidiary of Entergy Corporation. Thus, there are three corporate entities
15 separating ENVY from its ultimate corporate parent, Entergy Corporation.
16

17 **Q. What is the significance of the corporate separation between ENVY and Entergy**
18 **Corporation?**

19 A. This corporate separation is significant since Entergy Corporation is ultimately the provider
20 of all capital for ENVY. The companies that are organizationally located between ENVY and

1 Entergy Corporation are holding or investment companies with few hard assets behind them.
2 According to the response to DPS 2-10, none of these three corporate entities has any
3 employees. The form of corporate ownership proposed for ENVY could make it difficult for
4 ENVY to access capital from these holding or investment companies if the need arose.
5

6 **Q. What form of ownership is proposed for ENVY?**

7 A. ENVY is a limited liability company or “LLC”. According to an article provided in response
8 to DPS 2-9, a limited liability company “is an amalgam of the most desirable attributes of
9 corporations and partnerships. It can be viewed as a limited partner with no general partner
10 or a general partnership with no personal liability. It is a hybrid that combines the flow-
11 through tax advantage of a partnership with the limited liability protection of a corporation.”¹
12 What this means is that the liability of ENVY is limited to the actual assets that it owns.
13 There is no ability to reach back and force capital to be provided by its direct or indirect
14 owners. At the same time, ENVY is not considered a separate entity for tax purposes but
15 instead its earnings are consolidated with those of its owner, Entergy Nuclear Vermont
16 Investment Company. Should ENVY suffer a serious financial setback, its financial exposure
17 would be limited to the assets within the LLC.

¹ The ABC’s of LLCs (Limited Liability Companies): What Are They; Who Needs Them; And Is Vermont Ready For Them? By Steven Auderieth, Esq., Vermont Bar Journal and Law Digest, February 1995.

1 Another indirect Entergy Corporation subsidiary, Entergy Nuclear Operations,
2 Inc.(“ENO”), will be appointed as ENVY’s agent to operate and maintain Vermont Yankee,
3 so ENVY is not expected to have any operating employees.

4
5 **Q. Did ENVY provide any studies, or analysis as to why it was structured as a limited**
6 **liability company?**

7 A. No, we asked ENVY to provide “all studies, analyses, and reports addressing the evaluation
8 of corporate structures for nuclear operations”. We also asked for all studies, analyses, and
9 reports addressing the potential liability of Entergy Corporation due to its nuclear exposure
10 and for all documents presented to the Board of Directors of Energy Corporation regarding
11 the recommended corporate structure. All of these requests² were objected to by the
12 Company “on the basis of attorney-client privilege.” In addition, we requested copies of any
13 studies, analyses, and reports addressing the corporate structures currently utilized by other
14 owners of nuclear facilities. The Company responded that “Entergy is not aware of any
15 documents responsive to this request.”³

16
17 **Q. Can you evaluate the evidence provided by ENVY as to its ability to operate**
18 **Vermont Yankee from a financial perspective?**

² DPS 2-18, DPS 2-20, and DPS 2-21.

³ DPS 2-19.

1 A. Yes, in his Direct Testimony at page 8, Mr. Kansler states that “..the primary evidence of
2 the ability of Entergy Nuclear VY to successfully consummate the transaction and operate
3 the VY station is the track record of its parent, Entergy Corporation, which, through its
4 subsidiaries, has recently completed several similar transactions in the Northeast and is
5 successfully operating the plants that it has acquired”. This statement is both a comfort
6 and a concern.

7 Entergy Corporation currently has a BBB credit rating from Standards and Poor’s
8 (“S&P), which is only one step above the lowest investment grade rating of BBB⁴.

9 According to the Company’s Application to the NRC, six Entergy subsidiaries issue their
10 own debt. These six entities have ratings from S&P ranging from BBB+ to BBB- and
11 ratings from Moody’s ranging from Baa2 to Baa3.

12 There are serious industry-wide issues facing Entergy in its domestic regulated
13 businesses, its domestic non-utility nuclear business and its international trading
14 operations. Security analysts and rating agencies are currently scrambling to reassess the
15 stability of the companies in the energy sector in the wake of the rapid bankruptcy of
16 Enron Corporation, a company rated as investment grade during the weeks before its
17 collapse. Financial problems have also arisen recently for Mirant Corporation, Dynergy,
18 and Calpine Corporation. The domestic utility sector is grappling with the transition to
19 deregulation and the nuclear industry is facing additional security concerns, with renewed

⁴ Entergy Corporation was rated for the first time in June 2001.

1 calls to shut down plants, including the Indian Point Units owned by Entergy. Entergy is
2 pursuing increased investment in nuclear plants, with increased exposure to the risks
3 facing that industry. If this acquisition of Vermont Yankee is approved, it will bring to ten
4 the number of nuclear plants operated by Entergy⁵. In addition, Entergy has expressed its
5 intent to participate in an auction for the Seabrook Nuclear Power Plant, which may take
6 place as early as the first quarter, 2002.

7 In its most recent Annual Report to Shareholders, Entergy announced its intention
8 of spending \$8.2 billion in the 2001-2003 time frame on its capital investment plan⁶, or
9 more than 4 times its 2000 annual operating cash flow of \$2.0 billion⁷. Entergy states on
10 page 63 of its 2000 Annual Report to Shareholders that its investment plan “..is contingent
11 upon the ability to access the capital necessary to finance the planned expenditures, and
12 significant borrowings may be necessary to implement these capital spending plans.”

13 There may also be some increased financial uncertainty for Entergy resulting from
14 a recent FERC Order⁸ requiring Entergy to utilize “split-the savings” cost-based rates for
15 certain spot market wholesale sales. This methodology was ordered as part of FERC’s
16 adoption of a Supply Margin Assessment (“SMA”) screen to evaluate market power.

17 While I understand that certain aspects of the FERC Order have been stayed pending

⁵ Testimony of Mr. Kansler, page 16.

⁶ 2000 Annual Report to Shareholders, page 63.

⁷ Testimony of Mr. Kansler, page 8.

⁸ Docket No. ER96-2495-015 et al.

1 rehearing, the Order does raise some issues about Entergy's future pricing of wholesale
2 sales and curtailment of its ability to exercise market power.

3 In the international trading segment of the business, Moody's Research Opinion
4 for Entergy Corporation states, "At the parent, management focuses on Entergy
5 Wholesale Operations which combines growing global power development and power
6 marketing. Wholesale Operations will be restructured per Axia Energy (A3 sr. unsec.), the
7 trading and marketing subsidiary of Entergy-Koch LP. The LP removes risk from
8 Entergy's balance sheet as trading operations are now housed in the joint venture." It is
9 clear that there is significant competition for Entergy's financial resources and that its
10 ability to attract additional capital is not unlimited. These facts make it more critical than
11 ever that safeguards be put in place to ensure that ENVY receives its fair share of the
12 capital available to Entergy Corporation.

13
14 **B. Financial Assurances**

15 **Q. What financial guarantees or lines of credit are currently proposed for ENVY?**

16 A. According to the response to DPS 2-22, "Entergy Corporation has guaranteed the
17 payment by Entergy Nuclear VY of the Cash Purchase Price of \$180,000,000 which
18 means it will assure sufficient capitalization to close the transaction. In addition, Entergy
19 Corporation, through its subsidiaries, has made an aggregate of an additional \$70,000,000
20 available to Entergy Nuclear VY in the form of binding credit lines." Therefore, Entergy
21 Corporation is providing a corporate guarantee for the \$180 million purchase price of

1 Vermont Yankee. However, once the proposed purchase is completed, the only financial
2 commitments to ENVY are two credit agreements with affiliates. One of these
3 agreements provides for a credit line of up to \$35 million from Entergy Global
4 Investments, Inc. (“EGI”). These funds are intended to serve as working capital, if
5 required by Vermont Yankee. According to the testimony of Mr. Kansler at page 9,
6 ENVY anticipates that after five years of operation of the Vermont Yankee facility, this
7 credit line would be reduced to \$20 million.

8 The second agreement provides for \$35 million from Entergy International
9 Holdings, Ltd., LLC (“EIHL”), which is the parent company of EGI. This credit line is
10 not intended to be used in the normal course of business but instead is intended to be
11 utilized only in the event of a problem at the facility. According to the testimony of Mr.
12 Kansler at page 10, “[t]he primary purpose of the funds would be to pay costs during a
13 period between an unplanned shutdown of the plant and the availability of the funds from
14 the decommissioning trust. Reports will be made to the NRC when funds are drawn from
15 this facility, and the funds will not be reduced, replaced or withdrawn without express
16 NRC approval.” In response to DPS 1-52, the Company indicated that this \$35 million
17 “could be drawn upon in the normal course of business if the need arose”, but that this is
18 “not the intended use of the funds...”
19

20 **Q. Are these two lines of credit adequate assurance that ENVY will have sufficient**
21 **funds to operate and maintain Vermont Yankee?**

1 A. No, they are not. Both the amount of the credit lines and the source of the credit lines are
2 unacceptable. In addition, these credit lines could be in jeopardy if either EIHL or EGI
3 suffered financial hardship. There is also no assurance that ENVY would take the
4 necessary steps to call upon these credit lines should the need arise.

5
6 **Q. What are your concerns regarding the amount of the proposed lines of credit?**

7 A. The minimum amount of credit that should be available to ENVY is the amount required
8 to cover operating expenses between an unplanned outage and a premature shutdown of
9 the plant. I understand that after six months of an unplanned shutdown, the owner of a
10 nuclear facility can access decommissioning funds.⁹ However, it could be many months
11 after the start of an unplanned outage before a decision is made to shut down the plant
12 prematurely. In that case, ENVY may not be able to access decommissioning funds for
13 some period of time that is significantly longer than six months. Therefore, I recommend
14 that the Board require a line of credit to provide for operating expenses of at least one
15 year prior to a premature shutdown of the plant.

16 Another concern is that even under ENVY's proposal, considerably less than \$70
17 million may be available should the need arise. For example, if ENVY had already used
18 \$20 million of its line of credit prior to a problem that necessitated a premature shutdown,
19 or a prolonged unplanned outage, then considerably less than the full \$70 million would be

⁹ The costs associated with operating Vermont Yankee are discussed in greater detail in the testimony of David A. Schlissel.

1 available to ENVY. Therefore, I recommend that a minimum of one year of operating
2 expenses for the Vermont Yankee facility be made available to ENVY in addition to the
3 \$35 million working capital line to be provided by EGI.

4
5 **Q. Are there other problems with the proposed financing agreements as currently**
6 **structured?**

7 A. Yes, there are. For example, the current proposed letter of credit from EIHL for \$35
8 million will terminate and all loans extended under the agreements will become payable if
9 “ENVY has permanently ceased operations at the Vermont Yankee Plant¹⁰.” In response
10 to DPS 1-61(e), the Company confirmed that credit from EIHL may no longer be
11 available if ENVY declares that it has permanently ceased operations, stating “Upon
12 permanent cessation of operations, the EIHL agreement may be terminated. However, the
13 EGI line would be expected to be utilized until the decommissioning funds were
14 available.” As previously addressed, in that case the EGI lines may have already been
15 utilized as working capital, leaving ENVY without any financial resources.

16
17 **Q. What are your concerns regarding the sources of the lines of credit?**

18 A. An additional concern relates to the financial integrity of EIHL and EGI. EGI is a wholly-
19 owned subsidiary of EIHL. Moreover, neither EIHL nor EGI have any physical assets.

¹⁰ Exhibit MRK-4, page 9.

1 The result is that these two companies are only as strong as 1) their receivables from, and
2 investment in, associated companies, and 2) Entergy Corporation's commitment to
3 provide them with additional funds, if required. Entergy Corporation, therefore, has full
4 discretion as to whether or not to provide sufficient capital to EIHL and EGI so that these
5 two financing vehicles can meet their commitments to ENVY. If Entergy Corporation
6 should choose to walk away from EIHL and EGI, there appears to be no recourse for
7 ENVY.

8 EGI is a subsidiary of EIHL, which was formed in August, 1997. EIHL is itself a
9 limited liability company and it has one owner/member, which is Entergy Corporation.
10 Under the terms of the organization documents, "The Member is not required to make any
11 additional capital contribution to the Company¹¹." In addition, the organizational
12 documents state that "Distributions shall be made to the Member at the times and in the
13 aggregate amounts determined by the Member." That is, the member (Entergy
14 Corporation) is not required to make any capital contributions to EIHL or to EGI.
15 Entergy Corporation also has significant latitude to determine the amount of capital to
16 remove from EIHL and EGI. Therefore, there is no assurance that EIHL OR EGI will
17 continue to have sufficient capital in the future to meet their obligations to ENVY.

18
19 **Q. Assuming that EIHL and EGI continue to have sufficient capital, is there any**

¹¹ Response to DPS 2-3.

1 **requirement for ENVY to actually borrow funds from these entities should the need**
2 **arise?**

3 A. No, there is not. The financing agreements permit, but do not require, ENVY to borrow
4 funds should the need arise. Therefore, if at some point in the future Entergy Corporation
5 should decide that it is preferable to have ENVY in financial hardship rather than
6 providing additional funds to the Company, it could direct ENVY to forego additional
7 borrowings from EIHL and EGI.

8
9 **Q. What do you recommend with regard to the source of funding available to ENVY?**

10 A. In order to ensure that ENVY has sufficient capital, I recommend 1) that it have access to
11 at least one full year of operating expenses in the event of an unplanned outage, 2) that it
12 be provided with a line of credit for \$35 million in working capital in addition to the
13 financial resources required in the event of an unplanned outage; and 3) that Entergy
14 Corporation guarantee that these funds will be available to, and will be utilized by, ENVY
15 should the need arise. While I am not opposed to Entergy Corporation using EIHL and
16 EGI as financing vehicles, Entergy Corporation must guarantee that it will make the funds
17 available in the event that EIHL and EGI are unable to meet their commitments to ENVY.
18 Entergy Corporation should also guarantee that ENVY will call upon such funds, as
19 necessary. This agreement between Entergy Corporation and ENVY should be formalized
20 in writing. Moreover, the filing of a bankruptcy petition by ENVY should not invalidate
21 Entergy Corporation's commitments under this agreement.

1
2 **Q. What specific assurance has Entergy Corporation provided that ENVY will have**
3 **sufficient capitalization?**

4 A. When asked in a data request what recourse the Board would have in the event that it
5 found ENVY to have insufficient capital at some point in the future, the Company
6 objected to the request on the basis that it required a legal conclusion.¹² Therefore,
7 instead of providing assurances to the Board regarding Entergy Corporation's
8 commitment to ENVY once the facilities are acquired, very little assurance has been
9 provided.

10 In the response to DPS 2-41, the Company addressed the situation whereby
11 revenues from the purchased power agreement fell below the level needed for annual
12 operating funds. In that case, ENVY stated that it would have several options, among
13 them "the use of internal working capital, drawing upon credit lines, requesting repayment
14 of outstanding loans, seeking additional loans or capital from affiliates, deferral of non-
15 safety related capital expenditures, reduction in non-safety related operating expenses,
16 renegotiation of vendor contracts and implementation of additional revenue sources such
17 as an uprate. **Entergy Nuclear VY would also consider plant closure if the above**
18 **actions did not remedy the situation over the long term.**" (Emphasis added) Thus, the
19 Company has acknowledged that at some point it may be in the best interest of Entergy

¹² Response to DPS 2-23.

1 Corporation to terminate operations at Vermont Yankee rather than providing additional
2 funding to ENVY.

3
4 **Q. Why do you feel that a parent guarantee from Entergy Corporation is so important?**

5 A. This is a multi-faceted issue, as it requires an assessment of the financial strength of the
6 two subsidiaries, EIHL and EGI, that Entergy proposes will provide the necessary
7 financial guarantees. The Consolidated Statements of Financial Position for December 31,
8 2000¹³, show approximately 73% of the assets of consolidated EIHL (which includes EGI)
9 is comprised of notes from associated companies. It appears that neither EIHL nor the
10 associated companies can access significant amounts of cash except by request to the cash
11 management function of the Entergy Treasury Department. Thus, unless there is a
12 guarantee to ENVY from the parent, Entergy Corporation, there is no assurance that
13 EIHL will be in a position to actually provide the funds it has guaranteed it will make
14 available to ENVY. Moreover, EIHL has returned \$818 million of capital to its parent in
15 the 1999-2000 time frame. This transfer of capital and other activity reduced the
16 consolidated EIHL's cash on hand from \$813 million in 1999 down to \$78 million at the
17 end of 2000. This \$78 million of cash is overwhelmed by the \$1.6 billion of credit
18 extended by EIHL¹⁴. Clearly, if ENVY is to rely on a financial guarantee, it must have

¹³ Response to DPS 1-41.

¹⁴ Per the response to DPS 1-42.

1 such a guarantee from an entity with its own financial resources. Further, Entergy has in
2 the past contemplated a merger that would restrict its ability to incur or guarantee
3 indebtedness¹⁵. Any such restrictions on Entergy Corporation in the future would
4 seriously undermine the value of a guarantee from its subsidiaries. It is imperative that a
5 guarantee from the parent be secured for the operation of Vermont Yankee, while Entergy
6 Corporation still has the ability to offer such a guarantee.

7 Entergy Corporation should be obligated to stand behind the total financial
8 exposure occasioned by the ownership and operation of this nuclear power plant. It is not
9 reasonable to allow Entergy Corporation to shield itself from financial responsibility with
10 complex financial arrangements. It certainly should not be allowed to offer guarantees
11 from subsidiaries that do not have sufficient assets to meet their obligations on a stand-
12 alone basis, because the parent could walk away from those subsidiaries if its own interests
13 so dictated. If Entergy Corporation intends to stand behind the guarantees of its
14 subsidiaries, it should have no problem in making the guarantee directly.

15 The State of Vermont and the Board should have the right to demand the full faith
16 and credit of the parent company is pledged to support the operation of a nuclear plant,
17 given the implications for the safety of Vermont citizens and the importance of power to
18 Vermont's ratepayers and its economy. Entergy's current proposal attempts to trade on its
19 reputation, track record and its access to capital markets but it stops well short of actually

¹⁵ Per the 2000 10-K, page 5.

pledging these assets to the operation of Vermont Yankee.

Q. Have you quantified the amount of funds that should be guaranteed by Entergy Corporation to ENVY?

A. With regard to a working capital allowance, I am not opposed to the \$35 million proposed in the filing. In addition to this working capital requirement, I am recommending that Entergy Corporation provide a guarantee that it will fund a minimum of one year of annual operating costs that would be incurred by Vermont Yankee during an extended shutdown. The Board may want to require Entergy Corporation to establish a restricted account containing such funds prior to approving the proposed acquisition.

Q. Does your recommendation go beyond the financial requirements that are likely to be established by the Nuclear Regulatory Commission ("NRC")?

A. While the NRC has not ruled on ENVY's Application, in previous transfers involving Entergy Corporation the NRC has apparently not required the type of parent company guarantee that I am recommending here. According to a letter (included in Exhibit DPS-ACC-2) provided by the NRC to Christine Salembier, Commissioner of the Vermont Department of Public Service, it appears that the NRC's primary financial analysis considers the ability of a facility's operating revenues to meet its operating expenses. It does not appear that the NRC undertakes a rigorous analysis of the ability of the owner to meet operating costs given an extended shutdown of the facility. Nor does

1 the NRC appear to consider the impact on ratepayers and taxpayers of an extended outage
2 at the facility. Based on my review of this correspondence, the Board should not rely
3 upon the NRC to mandate the financial safeguards that are necessary to protect the
4 ratepayers and taxpayers of Vermont. The Board should take no comfort from the NRC's
5 financial review but instead should require those safeguards that it deems necessary.
6

7 **Q. Doesn't the Securities and Exchange Commission ("SEC") restrict the ability of**
8 **registered holding companies, like Entergy Corporation, from providing corporate**
9 **guarantees for non-utility operations?**

10 A. Under the Public Utility Holding Company Act ("PUHCA"), there are restrictions on the
11 corporation guarantees that can be provided to non-utility operations. However,
12 according to Entergy Corporation's 2000 Annual Report to Shareholders, "[i]n August
13 2000, the SEC issued an order, effective through December 31, 2005, that allows Entergy
14 to issue up to \$2 billion of guarantees to its non-utility companies, excluding guarantees
15 outstanding as of that date that were issued under a previous order."
16

17 **Q. How does this amount relate to Entergy's total capitalization?**

18 A. At September 30, 2001, Entergy Corporation had over \$26 billion of assets, including
19 \$16.9 billion in net property, plant, and equipment¹⁶. As of that date, the Company had

¹⁶ Consolidated Balance Sheet, 10-Q, September 30, 2001.

1 approximately \$7.8 billion in shareholders' equity and \$7.8 billion in long-term debt,
2 including long-term debt currently maturing. The remainder of its capitalization consisted
3 of \$3.5 billion in current liabilities and \$6.7 billion of deferred credits and other liabilities,
4 including decommissioning funds. Therefore, the corporate guarantees that I am
5 recommending in this case appear to constitute a relatively small portion of Entergy
6 Corporation's total capitalization.

7
8 **Q. Should the Board be notified in the event that ENVY draws upon its credit lines?**

9 A. Yes, it should. I recommend that ENVY provide quarterly notification to the Board
10 stating the amount of working capital drawn on the line of credit from EGI. In addition, I
11 recommend that the Board be notified immediately if ENVY draws upon the additional
12 financial guarantees recommended in my testimony. On page 10 of Mr. Kansler's
13 testimony, he states that reports will be made to the NRC regarding the credit facility from
14 EIHL, "and the funds will not be reduced, replaced or withdrawn without express NRC
15 approval." Similarly, the Board should be immediately informed of any event that
16 requires ENVY to draw upon its financial guarantee from Entergy Corporation. I am also
17 recommending that the Board be kept informed regarding the financial status of ENVY on
18 an ongoing basis. The cash management policies of Entergy were provided in response to
19 DPS 2-37. According to that response, each business unit must submit, on an annual
20 basis, a financial forecast that identifies cash flows with the parent company by month for
21 the next 24 months. I recommend that ENVY submit its annual forecasts to the Board as

1 well or provide other annual financial reports so that the Board can monitor the financial
2 health of ENVY on an ongoing basis.

3
4 **Q. Do you have any additional recommendations with regard to Entergy Corporation?**

5 A. Yes, as previously stated, Entergy Corporation's trading activities are now housed in a
6 joint venture that removes certain risk from Entergy Corporation's balance sheet. There
7 may be other joint ventures or other financial arrangements whose effects are not fully
8 revealed in Entergy Corporation's financial statements. It is just such arrangements that
9 contributed to the downfall of Enron Corporation and contributed to the fact that Enron's
10 true financial status was not recognized earlier by the financial community.

11 Prior to approving the proposed transaction, the Board should be certain that it has
12 a complete and accurate understanding of Entergy Corporation's financial condition,
13 including any financial exposure associated with off-balance sheet activities. All
14 guarantees that have been extended by the parent and its subsidiaries should be accounted
15 for in total with additional exposure also determined for off-balance sheet joint ventures or
16 investments in unconsolidated affiliates. One method for obtaining this information may
17 be to require an independent audit of Entergy Corporation for the express purpose of
18 quantifying the Company's potential financial exposure. Other methods of determining
19 this exposure may also be acceptable, as long as the Board can be assured that it has an
20 accurate picture of Entergy Corporation's total financial condition.

21 ‘

1 **C. Recommended Restrictions on ENVY**

2 **Q. In addition to requiring a financial guarantee from Entergy Corporation, are you**
3 **proposing any other recommendations with regard to the financing of ENVY?**

4 A. Yes, I am recommending that the Board place a restriction on the payment of dividends
5 that can be paid from ENVY to its corporate parent. The purpose of this dividend
6 restriction is to provide for internal funding of certain costs by ENVY and to ensure that
7 an adequate source of funds will exist to meet unanticipated expenditures. I am also
8 recommending that ENVY be prohibited from making loans to its affiliates without Board
9 approval.

10
11 **Q. Is ENVY proposing any dividend restriction or any restriction on loans to affiliates**
12 **in its filing?**

13 A. No, ENVY has made no such provision. The response to DPS 2-36 states “There are no
14 written procedures that govern the distribution of operating profits. Entergy Nuclear
15 Vermont Yankee, LLC would either make distributions to its immediate parent or would
16 make loans to affiliated companies depending on the specific cash requirements of its
17 parent and/or affiliates.” The response to DPS 1-27 indicates that “Entergy Nuclear VY is
18 expected to retain sufficient cash for working capital needs.” But this response also
19 indicates that “There is no formal written policy” regarding the retention of operating
20 profits by ENVY.

1 **Q. Should the Board be concerned about the absence of a policy regarding ENVY's**
2 **profits?**

3 A. Yes, it should. This lack of direct control over its internally generated funds, and the
4 vagueness of the corporate policy, does not provide an appropriate level of financial
5 assurance for the ownership and operation of a nuclear power plant. It leaves open the
6 possibility that Entergy Corporation could require 100% of operating earnings as
7 dividends from its subsidiaries, including ENVY, if it needed funds to meet other priorities
8 or emergencies, leaving the owners of the nuclear plants without sufficient capital to
9 pursue their own immediate priorities.

10
11 **Q. Does ENVY have a target capital structure, i.e. does it have a target for the**
12 **percentage of equity used for capitalization?**

13 A. No, according to the response to DPS 2-6, Entergy Nuclear Holding Company and each
14 of its direct and indirect subsidiaries are "internally funded entities, and as such, Entergy
15 does not have a target capital structure for these companies." The Company went on to
16 state that "The relative amount of internal debt and equity...fluctuates from time to time
17 and is determined upon discussion among Entergy's tax, treasury, legal, and accounting
18 functions." As this statement demonstrates, ENVY's financing, and therefore its
19 corporate viability, would be entirely under the control of Entergy Corporation as the
20 proposal is currently structured.

1 **Q. What do you recommend?**

2 A. I recommend that if the Board approves the proposed sale, it be conditioned upon
3 ENVY's agreement that dividends to its parent company will be limited to 50% of net
4 operating income for the first three years of operation, at which time the Board can review
5 this restriction and determine if it is still necessary. This policy will help to ensure that
6 ENVY will have the ability to build up its own reserve of working capital and/or to
7 internally finance capital expenditures that may be necessary. Moreover, it is possible that
8 a determination that an outage is permanent may not occur until an outage has persisted
9 for 6 months or more. Thus even a 6 month working capital provision may be exhausted
10 by ENVY prior to its ability to access decommissioning funds, making it even more
11 important for ENVY to retain some portion of internally generated funds.

12
13 **Q. Have Entergy subsidiaries been subject to dividend restrictions in the past?**

14 A. Yes, they have. According to the 2000 Annual Report to Shareholders¹⁷, Entergy
15 Corporation's Merger Agreement with Florida Power and Light Company limited
16 dividend increases to 5% over the amount of the previous 12-month period. While this
17 Merger Agreement has since been terminated, the fact remains that a dividend restriction
18 is not unfamiliar to Entergy. Moreover, placing a dividend restriction on dividends from
19 ENVY to its parent is not conceptually different from the limits placed by the SEC on

¹⁷ 2000 Annual Report to Shareholders, page 63.

1 Entergy Corporation's ability to utilize retained earnings for certain purposes. According
2 to Entergy Corporation's Annual Report to Shareholders, SEC regulations "limit Entergy
3 Corporation's aggregate investment in domestic and foreign generation businesses at the
4 time an investment is made to an amount equal to 50% of average consolidated retained
5 earnings for the previous four quarters. In June 2000, the SEC issued an order that allows
6 Entergy's exempt wholesale generator and foreign exempt utility subsidiaries' investments
7 to increase from 50% to 100% of Entergy's average consolidated retained earnings."¹⁸
8 The restrictions imposed by the SEC were designed to protect the regulated utility
9 businesses of registered public utility holding companies from activities that could threaten
10 the financial viability of the regulated entities. Given the economic and environmental
11 significance of Vermont Yankee to the State of Vermont, it is equally important that
12 restrictions be placed on funds internally generated by ENVY.

13
14 **Q. Are you also recommending that ENVY agree not to make loans to its affiliates**
15 **without Board approval?**

16 A. Yes, I am. The funds that are internally generated by ENVY could be removed from that
17 entity in one of two ways, either through dividend payments to its parent or through loans
18 made to affiliates. If the goal of the Board is to provide for retention of certain funds by
19 ENVY, then a prohibition on loans to affiliates is just as important as the dividend

¹⁸ Id., page 32.

1 restriction discussed above¹⁹. Since the capital that flows out of ENVY through loans
2 made to affiliates may be returned at some point through repayment of those loans, a loan
3 does not necessarily result in the permanent transfer of capital out of ENVY. Therefore, I
4 am not recommending a prohibition on any and all loans from ENVY. However, I do
5 recommend that ENVY agree to obtain Board approval prior to making any such loans.
6 This will provide a mechanism for the Board to review the financial situation of ENVY
7 and the creditworthiness of the borrower prior to approving any such loans.
8

9 **V. CONCLUSIONS**

10 **Q. What conclusions can be drawn from the forgoing picture of Entergy Corporation**
11 **and ENVY with regard to continued operation of Vermont Yankee?**

12 A. There are several issues that surface from the broad picture described above that require
13 special attention in the evaluation of Entergy's ability to operate Vermont Yankee. First,
14 the guarantees provided to ENVY as owner of the plant must be backed by the guarantee
15 of the parent, not of a subsidiary. Second, Entergy Corporation should furnish guarantees
16 sufficient to cover costs for at least one year in the event of an unplanned outage and
17 ENVY should be required to call upon such funds, if needed. Third, Entergy should
18 immediately notify the Board if it draws upon this line of credit from Entergy Corporation.
19 Fourth, ENVY should be provided with a separate working capital line of credit of \$35

¹⁹ The SEC also restricts certain loans pursuant to PUHCA.

1 million as proposed in the Application. Fifth, ENVY must have the ability to manage its
2 own internally generated cash flow. Sixth, restrictions should be placed on dividends at
3 least for the first three years of operation. Seventh, ENVY should be restricted from
4 loaning its funds to its parent or other subsidiaries without Board approval. Finally,
5 ENVY should annually report on its financial condition to the Board and the Board should
6 obtain a complete financial evaluation of Entergy Corporation prior to approving the
7 proposed sale.

8 I recommend that the Board not approve the proposed sale unless the conditions
9 outlined in my testimony, or similar conditions that address these concerns, are met. In
10 addition, there may be additional safeguards that the Board determines are necessary in
11 order to protect Vermont's ratepayers and taxpayers.

12
13 **Q. Does this conclude your testimony?**

14 **A.** Yes, it does.